



State of Wisconsin

CORRESPONDENCE/MEMORANDUM

Department of Agriculture, Trade and Consumer Protection
Division of Trade and Consumer Protection

Date: February 10, 2010

To: Sen. Kathleen Vinehout, Chair - Senate Committee on Agriculture and Higher Education
Rep. Amy Sue Vruwink, Chair - Assembly Committee on Agriculture

From: Janet Jenkins, Administrator *Janet Jenkins*
Division of Trade and Consumer Protection

Subject: SB 527 and AB 717 relating to producer security

Thank you for the opportunity to testify in support of SB 527 and AB 717. The department requested this legislation and participated in drafting it. The department believes that it represents solid improvements to the producer security program that benefit contractors, has no adverse effect on producers, and does not create any additional regulatory burden. The legislation before you represents a general consensus between industry and producer groups and incorporates recommendations proposed by a special Producer Security Work Group and Grain Efficiency Committee established by the department for the very purpose of recommending changes to the producer security law.

Overall Goals and Impacts of the Legislation

The department seeks to accomplish a number of objectives through this legislation:

- Continue to provide producers with some measure of protection in the event of a contractor default.
- Reduce the cost of compliance. Some industry organizations claim that compliance with producer security regulation is too burdensome and expensive. These bills relieve some of that burden without significantly reducing protection for producers.
- Clarify existing language. Some portions of the current law could be clearer and this legislation provides that clarity.
- Remove irrelevant provisions. There are provisions in the current statute that are no longer applicable because they have been replaced by administrative rule provisions or because they were phase-in provisions. This legislation deletes them.

Summary of Cost Savings and Need for Desirability of Prompt Action

The department estimates that the cost savings to contractors resulting from the proposed legislation will be:

- \$1 million annually in financial statement preparation costs for grain dealers & warehouse keepers;
- \$500,000 annually in financial statement preparation costs for milk contractors;

- \$5,000 annually in assessments on milk, grain, and vegetable transactions between producers and contractors with common, controlling ownership;
- \$15 million in individual contractor security filed with the department that will be released immediately and be available for other uses; and,
- Up to \$150,000 for the costs of maintaining that \$15 million.

Since these costs savings are significant, the department requests that you act with all deliberate speed in acting upon the legislation since those savings will take effect at the beginning of the next license year. The next license year for milk contractors begins May 1. (Other industry groups will realize the savings as their next license year begins at subsequent times during 2010.)

History of the Proposed Legislation

Wisconsin has had a producer security program since the 1930s. It was designed to provide regulations that minimize the risk that dairy plants, grain elevators, and vegetable processors will default on payments to farmers for milk, grain or vegetables. Another goal of the program is to help farmers recover in the event a default does occur.

The program has evolved over the years. Most recently, in 2002, the legislature converted the program from one under which most contractors filed individual security with the department to one that created an "indemnity fund" to which contractors contributed. This change enabled the department to release approximately \$100 million in security that, in turn, enabled contractors to use that money for other purposes.

In crafting the 2002 changes, neither the Legislature nor the department intended that the assessment fund would be grown to a point where it could cover the largest possible default. Rather, the law envisioned that the department would obtain "contingent financial backing", such as a bond, a loan or other type of surety to supplement the fund. Since 2002, the department has repeatedly attempted to obtain contingent financial backing with limited success. After September 11, 2001, the original idea of obtaining a bond or other surety evaporated.

In 2007, the department and producer security stakeholders began an intensive analysis of the program. Part of the reason was to address the inability to obtain contingent financial backing. Other reasons included concerns raised by industry regarding the cost of the program. To address these and other issues, Secretary Nilsestuen formed the Special Work Group on Agricultural Producer Security to take a broad view of the program and make recommendations. The department also formed the "Grain Efficiency Committee" to examine how the department could most efficiently perform its task of auditing grain elevators.

After these groups completed their work and made recommendations, the department began the implementation process. Some recommendations required nothing more than changes in departmental practice. Others required rule changes that are now in place. Some

recommendations require statutory changes, and those changes precipitated the legislation now under consideration.

Major Provisions of the Proposed Legislation

1. SB 527 and AB 717 substantially change the law's requirements for filing financial statements to the benefit of contractors.

Current law requires most licensed contractors to file an annual financial statement with the department. Generally, the law excuses "small" contractors from this requirement; "medium-sized" contractors are required to file a financial statement that has been *reviewed* by a CPA; and, "large" contractors are required to file a financial statement that has been *audited* by a CPA. The law currently defines small, medium, and large contractors by the dollar amounts of products purchased, except grain warehouse keepers, which use bushels stored.

SB 527 and AB 717 revise the form of measurement: for grain dealers it will be bushels purchased and for milk contractors it will be the number of hundredweight purchased. The bill also changes the threshold requirements for filing a reviewed statement and an audited statement.

These changes will mean that fewer contractors will be required to file the significantly more expensive audited financial statements, fewer will be required to file the less expensive, but still costly, reviewed financial statements, and that more contractors will not be required to file any financial statement.

2. SB 527 and AB 717 revise the calculation of "estimated default exposure" for those milk contractors that must file individual security resulting in savings to those contractors.

Currently, some contractors must pledge individual security to the department for the benefit of producers in the event of a default. In some cases, the security is required in lieu of participation in the producer security fund. In others, individual security is required in addition to participation in the Fund. In still other cases, contractors voluntarily file individual security in exchange for reduced assessments.

For milk contractors who are currently required to file security, the amount of that security is generally 75% of the highest amount the contractor owed to producers at any time during its most recently completed fiscal year or any time since. Under the proposed legislation, the required security is generally 75% of the highest amount the contractor owed to producers at any time during the most recent twelve months.

Shortening the look-back period will result in lower individual security requirements because the effect of any short-term, but significant price spikes creates an unrealistic view of how much a contractor owes producers at any given time. In shortening the look-back period, the effect of such spikes on the amount of security required will be significantly diminished.

Since most providers of security, e.g., banks, charge on the basis of the amount of the security provided, lower security requirements translate into lower costs for contractors. Lower security requirements can also positively affect contractor balance sheets and the attendant ability of contractors to obtain more credit or credit on terms that are more favorable.

The department currently holds approximately \$61 million in milk contractor individual security. If this legislation were to pass today, the department could release approximately \$15 million of that security, freeing it up for other uses.

3. SB 527 and AB 717 address transactions between producer and contractor entities that have at least a 50% ownership interest in each other.

Under current law, there is no unique treatment for sales between a producer and a contractor that share a common, controlling ownership. Treating these distinctive situations in the same manner as all other transactions leads to the absurd result of requiring these contractor/producer entities to protect themselves from themselves or making a claim against the fund for what amounts to their own default.

Under the proposed legislation, if a producer (or the persons who own the producer) has greater than a 50% ownership interest in a contractor, and the contractor (or persons who own the contractor) have greater than 50% ownership interest in that producer, the producer may not file a claim against the fund in the event of a default. Further, the contractor may disregard any purchases from this producer for purposes of calculating assessments or determining financial statement filing requirements.

The legislation also provides that default claims against the fund may be restricted or denied in the event a producer claimant had substantial management control over the contractor, ownership influence on the contractor or conspired with the contractor to create the default claim. Again, a producer that has substantial management control over a contractor presumably has the ability to require payment from that contractor.

The few contractor/producer entities that fall into this category will have reduced assessments because of the changes.

This provision does not provide an exemption for cooperatives. In a typical cooperative, each producer member owns a share of the contractor. However, the contractor, i.e., the legal entity known as the cooperative, typically does not have controlling ownership in their patron farms.

4. SB 527 and AB 717 disallow producer default claims in circumstances where allowance is illogical or unwarranted.

Current law already contains restrictions on what claims are allowed. For example, claims are not allowed if a producer fails to notify the department within 30 days after the default

occurred, or if the producer continued to deliver product more than 10 days after learning of the default.

The proposed legislation adds prohibitions against a few additional types of claims, including:

- Claims by producers who hold un-cashed checks for more than 30 days.
- Claims under grain deferred payment contracts where payment terms extend beyond 120 days past delivery.
- Claims under vegetable deferred payment contracts where payment terms for crops delivered one year extend beyond January 31 of the following year.

Each exclusion involves a choice by a producer to defer actual receipt of a contractor's payment or an obligation to pay for products sold to the contractor. Put another way, the producer is choosing to extend credit to the contractor. The longer credit is extended, the greater the risk of non-payment. The proposed legislation does not prevent producers from extending payment terms for products sold, but it does provide that the risk of extended payment terms falls upon the producer, not the fund or the other producers who look to the fund for payment in the event of a default.

5. SB 527 and AB 717 clarify that purchasing "contingent financial backing" is an option, not a requirement.

As set forth previously, the department has attempted to obtain contingent financial backing on a number of occasions. While the department has been unable to purchase the originally intended bond or other surety, it did purchase a policy of trade credit insurance in 2008 at the recommendation of the Producer Security Work Group. The insurance coverage proved to be somewhat illusory since the insurer retained the right to reduce or eliminate coverage during the policy term and exercised that right on a number of occasions.

The department chose not to review that policy when it expired in 2009, but did explore a policy under which the insurer could not reduce or cancel coverage during the term of the policy. The department concluded that such a policy was too expensive. The department acknowledges that contingent financial backing that provides a real value at a reasonable price might be available in the future, in which case the department will revisit this option. Until such time, however, the department wants to avoid inaccurate expectations and ensure that all stakeholders recognize that acquiring contingent financial backing is an option, not a requirement.

The proposed legislation will also "officially" allow the department to consider trade credit insurance as an option for contingent financial backing.

6. SB 527 and AB 717 adjust the department's ability to adjust assessment amounts by administrative rule

The department currently *may* adjust assessments by administrative rule. Further, the department *shall* adjust assessments by administrative rule if the overall fund balance, or the balance for any one of the four portions of the fund, falls either above or below explicit, statutory maximum and minimum balances. The law also leaves the amount of any increase to the department's discretion.

The proposed legislation provides that any such change in assessments may not take effect until the beginning of the next license year. This revision provides greater stability for contractors since it prohibits immediate increases in assessments.

SB 527 and AB 717 also allow the department to use emergency rulemaking procedures without requiring a finding of emergency, but **only** if there is a default in one of the four portions of the fund (grain dealer, grain warehouse keeper, milk contractor, and vegetable contractor), and **only** for the purpose of increasing assessments for that industry in which the default has occurred. In all other instances, requests for assessment increases must follow the normal rule-writing process.

The department believes that this limited ability to increase assessments by emergency rule is necessary in order to ensure that in the event of a subsequent default by any contractor, the fund will not be so depleted as to provide very limited compensation for the producers who have not been paid.

7. SB 527 and AB 717 revise the procedure for disqualifying existing contractors from participation in the fund thereby providing increased protection to contractors.

DATCP may currently disqualify a contractor from the fund, for cause, by "written notice". Under the SB 527 and AB 717, DATCP may only disqualify a contractor by issuing an administrative order. While the department only issues a "written notice" after careful review and consideration, an administrative order mandates the use of certain procedures and provides certain, prescribed rights for contractors who wish to contest the order. Since disqualification from the fund can have serious consequences, the department believes that the more formal, administrative order provision is more appropriate.

8. SB 527 and AB 717 remove non-substantive, obsolete provisions.

Many provisions in the current law are no longer applicable because they relate to provisions that were phased in between 2002 and 2006 or because the department has already exercised its rulemaking authority to modify certain statutory provisions. This legislation eliminates obsolete text.

Again, thank you for this opportunity to testify in support of the legislation.



KATHLEEN VINEHOUT

STATE SENATOR

Testimony in Support of Senate Bill 527 and Assembly Bill 717
Senate Committee on Agriculture and Higher Education
Wednesday, February 10th, 2010

Members of the Senate Committee on Agriculture and Higher Education and Assembly Committee on Agriculture, thank you for coming to the Joint Public Hearing today and for your consideration of Senate Bill 527 and Assembly Bill 717, relating to the Agricultural Producer Security Program.

The Agricultural Producer Security program was designed to protect agricultural producers from financial defaults by those purchasing the producer's products. Persons who purchase grain, milk or vegetables from Wisconsin producers and grain warehouse keepers who store grain for others participate in the program.

DATCP approached Rep. Vruwink and I to ask us to draft a bill that would make crucial updates to the Agricultural Producer Security Program. DATCP convened a "Special Work Group on Agricultural Producer Security" comprised of 21 individuals representing diverse interests in Wisconsin's dairy, grain and vegetable processing industries. The Special Work group met six times between October 2007 and April 2008 to examine the program and make recommendations for improvements.

Senate Bill 527 and Assembly Bill 717 embody the recommendations of the Special Work Group. The changes these bills propose to make are consensus recommendations. The bill seeks to reduce the cost of compliance by streamlining regulation while still maintaining protection for producers. The bill clarifies ambiguities in existing statutory language relating to producer payments and contingent financial backing requirements. It also provides a technical clean up of out-dated language used for phase-in provisions and language that has been replaced by administrative rule.

This program has provided protection to Wisconsin's farmers for nearly 70 years. It is essential that everyone involved in the business of agriculture has a reliable and efficient program to protect producers in the event of a default. The necessity of a reliable and efficient program is especially true given the hard economic realities and financial markets that we currently face.

Thank you for your time and attention to this matter. Officials from DATCP and members of the Special Work Group on Agricultural Producer Security a present and will provide greater detail on the proposed changes to the program.



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Date: February 10, 2010
To: Members, Senate Committee on Agriculture & Higher Education and
Assembly Committee on Agriculture
From: John Manske, Cooperative Network
Re: Support for Senate Bill 527/Assembly Bill 717

Cooperative Network represents 600 cooperatives, mutual insurance companies, and credit union owned by approximately 2.9 million Wisconsin members. Among our members are 60 farm supply and dairy cooperatives. The vast majority of them are participants in the Agricultural Producer Security (APS) Program as grain dealers, grain warehouse keepers or milk contractors. I am appearing today to register our support for Senate Bill 527 and its companion Assembly Bill 717.

I am among 10 individuals who serve on DATCP's Agricultural Producer Security Council, which was created through 2001 Act 16. I am one of the "charter members" of the council, having been the sole representative of Cooperative Network since the council's creation. Our statutory assignment is to advise DATCP on the administration and enforcement of the APS. DATCP is to consult with the council before acquiring any contingent financial backing and before modifying any license fee, license surcharge or fund assessment pertaining to the APS.

At the July 29, 2009 meeting of the council, I made the motion to "acknowledge with support (DATCP's) preliminary discussion draft," which is now before you as SB 527 and AB 717. Our support of the DATCP APS proposal is based on language incorporated in a resolution on Producer Security that was approved by our membership at Cooperative Network's 2009 Annual Meeting last November. An excerpt from our resolution states, "changes will have to be enacted if the program is to become what it was intended to be – a cost savings to industry and a more timely and efficient system to protect producers in the event of a business failure." SB 527 and AB 717 contain a number of provisions that will reduce cost for some contractors and also protect the fund from certain "unreasonable" claims in the event of a business default.

I do suggest you evaluate Section 152 of the legislation, which gives DATCP emergency rulemaking authority for modifying assessment rates, and the authority to do so without stating that the emergency rule is necessary for the "preservation of the public peace, health, safety, or welfare." I am not sure how often the legislature has granted DATCP or other agencies the authority to promulgate an emergency rule without complying with the standard requirement for emergency rules.

Finally, I want to acknowledge another APS proposal which Chairperson Vruwink and Representative Brooks have circulated, LRB 3926/1. It would provide a one-year assessment "holiday" for milk contractors, beginning with the May 1, 2010 license year. With \$7 million of the over \$10 million current APS fund balance derived from milk contractors, Cooperative Network believes that this additional proposal is well timed, especially with the current financial challenge facing the dairy industry. We suggest that the language found in LRB 3926/1 would be a suitable amendment to SB 527/AB 717.

Thank you for considering our comments.



Memorandum

February 10, 2010

To: State Legislators

From: Wisconsin Cheese Makers Association

Re: **WCMA Support for AB 717 and SB 527; Agricultural Producer Security bills**

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Wisconsin Cheese Makers Association, a member of the Agricultural Producer Security Council and representing a majority of Wisconsin milk contractors impacted by s. 126, supports the bills before the Senate Committee on Agriculture and Higher Education and Assembly Committee on Agriculture today.

Positives

A key proposal in AB 717 and SB 527 will allow milk contractors that purchase less than 2.5 million hundredweights of milk to prepare reviewed financial statements, rather than audited financial statements, for WDATCP regulators. Statewide, the change will save hundreds of thousands of dollars in accounting fees.

In addition, the bill heeds industry's call for language that links a default to a specific industry for repayment. In other words, one industry will face new assessment rates if a default in that industry depletes the indemnity fund.

Possible Corrections

WCMA wishes to point out technical issues in the bill for committee discussion:

Section 93: 126.47 (7)(a) and (am) open with statements that the department 'may' release security held by contractors after all financial requirements are met for two consecutive years. Considering that every obligation is met for this extended period of time, WCMA asks that the wording in 126.47 (7)(a) and (am) should be rephrased "The department shall release security..."

Section 139: Gives a third party insurer (not the state) statutory authority to collect from defaulting contractors. Relatedly, Section 148 of the bill gives WDATCP authority to revoke a milk contractor license if a contractor fails to reimburse the department 'or any other person' within 60 days.

WCMA is concerned that WDATCP is offering the power of the state to assist insurance companies in getting repaid and is requiring WDATCP step in and take a milk contractor license if a contractor fails to pay a third party in 60 days. These provisions move beyond the scope of protecting producers. The U.S. court system exists for private debt collection concerns, not the WDATCP APS program.

Section 152: Gives WDATCP the power to prepare fast-track emergency rules by avoiding certain requirements of the emergency rule statute. WCMA asks that this section be clarified to assure that other provisions of s. 227.24 (the Emergency Rule statute) are followed, including the requirement for public hearings.

Section 152: An Ag Producer Security Council recommendation to limit new assessment rates to no higher than the level of first-year assessment rates was not added to this section of the bill. Industry supports a known cap for any new assessment levied to rebuild the fund.